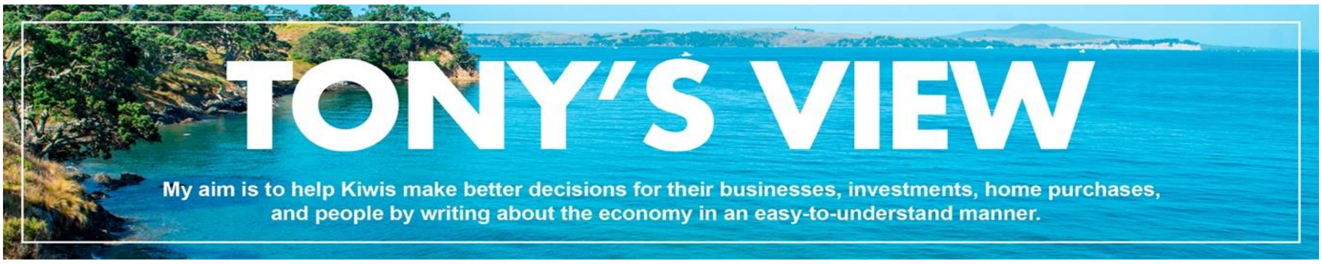

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17 reasons why the boom is over, 19 reasons why there's no crash

The prices boom in the NZ housing market is close to being over and next year will look quite different from 2020 and 2021. More normal. There will be talk about price falls in some locations, low FOMO, talk about brain drain and over-construction, and widespread misunderstanding as to why the Reserve Bank will keep raising interest rates if house prices are no longer soaring.

My aim with my publications and commentary has always been to make people better informed about the various forces in play as they make decisions regarding home purchase, borrowing and so on. That is why I've been increasingly shifting my focus in recent months from the factors which have caused average house prices to soar since 1992 and since March 2020 towards why growth will flatten out next year. I've used the phrase "We are in the end-game" for the three time periods of 1992 onward, post-GFC, and since May last year.

There is going to be some confusion. Some people will not recognise the ground shifting under them and will pay too much for a property and over-extend themselves. Some already have, especially for development land. Others will adopt an excessively negative view of the economy and housing market, backed up by things such as what appears to be happening with development land in South Auckland currently. Wondering why Auckland RVs are delayed?

This always happens when a market turns and when people do not sufficiently understand the various forces at work and how they interact with each other.

So, to help build people's understanding of why 2022 is going to be a different year in the NZ housing market, here are two lists.

The first list is of factors which will cause the pace of house price inflation to slow down. The second list is of factors which will support house prices and without which the first list would suggest a decent decline in prices over 2022 and 2023.

I invite you to place your own weighting upon each factor and to add other positive and negative factors for your own analysis. At the regional level in particular I suggest you look at recent population growth rates and projections from Statistics New Zealand. Maybe you need to compare those numbers with the growth in dwelling consents because in some parts of the country there will be over-building and an eventual excess supply of sections. That will mainly be a story for 2023 and beyond, but the discussion will commence before the end of 2022. There are not housing shortages everywhere in New Zealand.

Note that my analysis and commentary here is focussed on movements in house prices. Sales are something different.

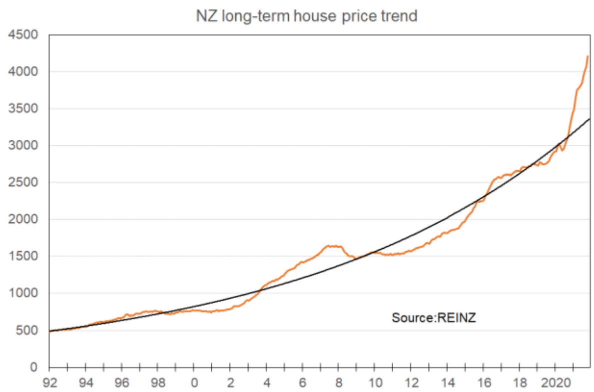
- Capitulation of vendors holding out for extremely high prices,
- loss of fear that one might sell but not be able to buy again,
- profit-taking by those who have gained from the boom, and
- selling by those seeking to rebalance their wealth portfolio

will keep sales levels supported. Listings will go back up again and for first home buyers this will be very positive – especially once banks get past their scramble to meet new lending requirements and settle into more stable and reasonable assessment regimes. February is likely to bring many tired and stressed buyers back into the market after a hopefully decent break from auction bid fails.

Reasons why house price inflation will potentially stop

1. Prices well above trend

Here is a graph I have not produced before. It starts in 1992 and shows the nationwide House Price Index calculated by REINZ and the Reserve Bank. The index is rising over time and the trend is shown by the black curve which takes into account the same percentage change in the index producing a greater rise in its nominal level along the vertical axis. Following the 39% surge in prices since March last year the average level of prices is about 25% above the long-term trend.



This does not tell us where prices are headed let alone at what pace. All it does is tell us that things are a long distance from where they would have been without the global pandemic. By implication, when the pandemic fades, some of the artificial boost will unwind. Good luck picking a timeframe and magnitude for that.

2. Borrowing costs increasing

This table shows what the best available fixed rates on offer were by the lenders I track some seven months ago. The second column shows the rates now and the third the difference.

	Apr-21	Current	Diff
1 year	2.29	3.49	1.2
2 years	2.49	4.15	1.66
3 years	2.65	4.49	1.84
4 years	2.99	4.69	1.7
5 years	2.99	4.85	1.86

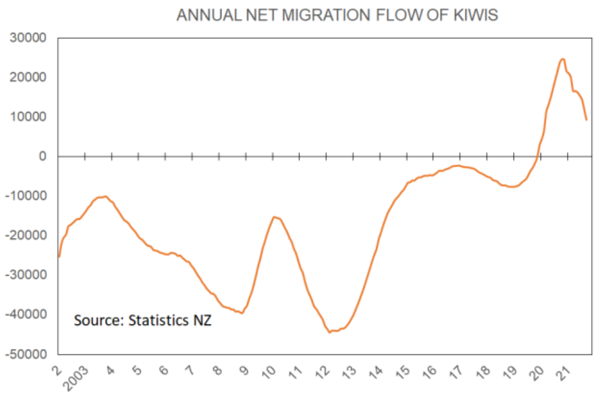
Some people might be shocked by these rises, and some are calculating percentage changes in the percentages – that is not what you do, fun as you might think it is. Rates are up, but only roughly back to where they were in early-2019. Were rates back then collapsing the housing market? No. So watch out for fidgety people preaching apocalypse on the back of a simple removal of the unusual monetary policy stimulus applied last year and in 2019.

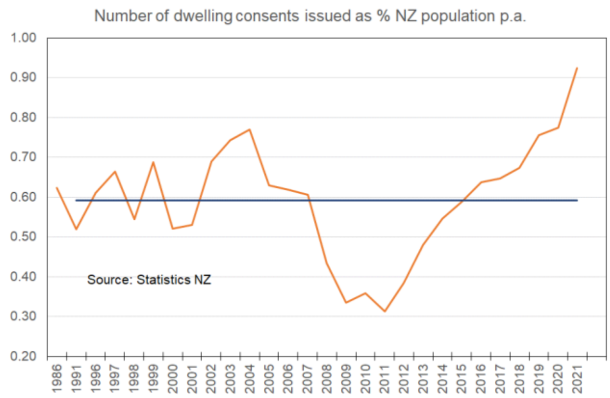
	Apr-19	Current	Difference
1 year	4.05	3.49	-0.56
2 years	4.29	4.15	-0.14
3 years	4.49	4.39	-0.1
4 years	5.19	4.69	-0.5
5 years	5.39	4.79	-0.6

But borrowing costs are up and will go higher and that will provide considerable restraint on the housing market. The 3-5 year fixed rates are likely to rise up to another 1% over 2022, the 1-year rate up to another 2%.

3. Net migration outflows

My view is that when the borders properly open a generation of young Kiwis will depart our shores for Australia for the higher wages on offer, lower cost of living, lower house prices, greater range of house types and locations to choose from, and simply to embrace some freedom after two years being cooped up one way or the other. Add in catching up on two years' worth of OE and we get a movement of the net annual flow of Kiwis back into negative territory, as has been the norm. The past few years from 2015 have been unusual.





4. Booming new house supply

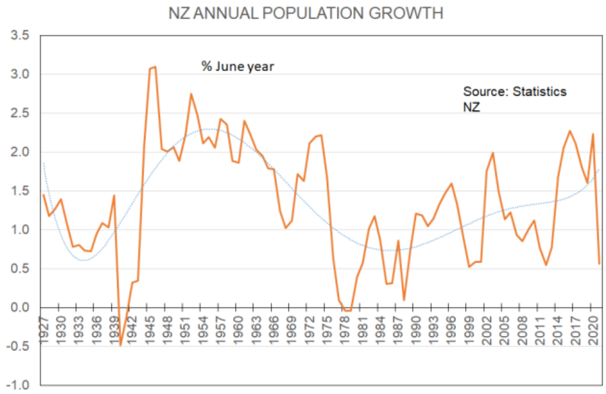
On average since 1986 the number of consents issued each year relative to the NZ population has been almost 0.6%. At 47,300 the latest such ratio is 0.92%. But if we focus on the underlying annualised pace of issuance in recent months at 51,000, then the ratio is almost 1%. Back in 1975 the ratio was near 1.3 so supply growth has been stronger. But the current building boom is the most substantial since the early-1970s.

More supply will act to constrain price rises. But there is a twist of the brain here which people need to be aware of. It goes like this.

- Prices are high. “OMG, what could get them down?”
- Higher supply – basic economics.
- “So, we need more houses. We don’t have enough houses. That means we have a shortage!”
- “That means we need more sections, we need more infrastructure, we need more builders, we need more migrant drainlayers, we need more materials. There are shortages everywhere.”

No there aren’t. There is simply acknowledgement that extra supply of a thing ceteris parebus will constrain prices. That is not the same thing as saying there are not enough houses for people to occupy. Prices have not soared 39% since March 2020 or 170% since 2009 because population growth has boomed. The shortage talk delivers easy understanding to people regarding house price rises, but it is a red herring and is set to produce some bad outcomes such as the denigration of living quality for some set to come from the new intensification rules. Panicked policy is bad policy.

The best thing many regions will have going for their population growth prospects in the next two decades will be the worsening of living conditions in our five biggest cities set to occur as a result of the three storey boxes about to be crammed onto sections next door to people against which they can lodge no objection as sunlight disappears and cars park on their berm. If the rules go ahead unchanged some who can leave the cities likely will, and if I were working in a region promoting it, I'd initiate a campaign highlighting how my town could offer sunshine and a backyard for one to rest in or one's kids to play in without mid-rise neighbours perving on. But that is something for down the track, not this coming easing leg of the house price cycle.



5. Overseas travel reopening

One small cause of strong prices growth recently has been people taking money they were going to spend on offshore travel over 2020 and 2021 and allocating it instead towards property investment or a new house. I feel this effect was small, but whatever the size, it is set to reverse. The bigger effect is probably this next one.

6. Time-shift reversal

Seeing borders closed with uncertainty about when they would open again, some people will have shifted their plans through time. Rather than travelling for a few years then buying a house they decided to buy a house then travel further down the track. As borders open that effect will disappear and the people who had been planning to buy a house over 2022-23 will perhaps already have done so. This means there will be a small hole in the normal level of housing demand coming up.

7. Life decision acceleration

Some people will have responded to worries about their mortality and not being able to enjoy the retirement or life they want by bringing relocation, upgrade, or downgrade plans forward in time. People planning to shift to their preferred retirement location may already now have done so – hence the rush for new houses in the regions.

As with the time-shift factor noted above, this means that normal demand in retirement locations which would have been there over 2022-23 will now not be there. Another small hole will become apparent.

8. Buying to beat restrictions

One reason why the pace of house price inflation has accelerated since June is people trying to make a purchase as quickly as possible in order to beat expected increases in borrowing costs and tighter lending restrictions. Now, that surge will fade because either the purchase has been made or the people trying to buy could not manage it and are now excluded because of the list of factors I shall run-through now.

9. Tighter LVR restrictions

For a while from May 1 last year through to February 1 this year there were no LVRs in New Zealand apart from those which some banks started to reintroduce late in 2020 as they grew concerned about the feeding frenzy which was underway.

The LVRs returned at old levels from February 1, then from May 1 investors needed a 40% deposit. Then from November 1 banks needed to make sure low deposit lending did not exceed 10% of total new lending each month. Clearly some became concerned that ratio could be breached when the monthly books closed, so they have stopped low deposit lending for a while.

The greater the deposit requirement the smaller the number of people who are in a position where they can make a desired property purchase.

10. New CCCFA requirements

From December 1 lenders to consumers need to undertake the deepest examination of loan applicant income stability and expenses that we have ever seen in New Zealand. Many applicants now cannot qualify for a mortgage. This includes people for whom retirement might come within 15 years of a mortgage being taken out, and the self-employed. It even for the moment includes those for whom income in the near future is in doubt because they refuse to get vaccinated and may lose their job.

11. Banks applying DTIs

Last week the Reserve Bank invited submissions on the potential introduction of debt to income limits on registered bank lending. In anticipation of the rules eventually coming into play late next year some banks have begun experimenting and testing their systems by applying a DTI of six to many borrowers. This action will spread in coming months and again, some borrowers will find they no longer qualify for a loan.

12. Minimum test interest rates

The Reserve Bank is also contemplating the potential introduction (probably after DTIs) of minimum interest rates which banks must use when calculating debt servicing ratios for borrowers. Note that the Reserve Bank also now has the ability to set maximum debt servicing ratios but for the moment is not investigating potential application of such rules.

13. Investor tax hit slow burn

From March 27 this year investors purchasing an existing property can claim none of their interest costs as an expense against rental income. Over the next three and a bit years this deduction removal will impact 100% on those who already owned an investment property on March 27.

In the context of their mortgage rates rising as they roll off their one-year fixed rates into much higher rates through 2022, the cash flow impact will encourage some to sell.

14. Cost of living up

The rate of inflation has hit 4.9% and is set to come close to 6% soon. The hike in the cost of living for people will impact their ability both to save a deposit and to meet bank debt-servicing requirements.

15. Slower population growth long-term

This factor is not particularly relevant for the next two years but is of importance for where prices go long-term.

New Zealand's population grew by about 46% between 1989 and 2018. But courtesy of Baby Boomers leaving this mortal coil and the fertility rate already dropping in the past ten years from 2.1 to 1.6, population growth for the next 30 years will be only 27% according to the most recent Statistics NZ projections.

16. Portfolio rebalancing

Most of us in some way are wealth-focussed, usually for the reason of financing a good retirement. One of the key things which Financial Advisors emphasise is the need for diversification. Average Kiwis have now developed very undiversified portfolios as a result of house prices soaring so much in the past two years.

The key thing here is to realise that while sharemarkets have also soared, hardly anyone has geared their capital into equities like they have into residential investment property. Therefore, the net wealth gain on one's property investment easily exceeds the net (after debt) wealth gain from other investments.

It is likely that people will be seeking to improve diversification in their portfolios now by placing new savings more into portfolio assets like shares, precious metals, cryptos etc. rather than residential property. Outright selling of property will be done by some, but this factor is likely to be small.

17. Wealth target met

Many people will have a view on the level of wealth they need heading into retirement. Some people will have been planning to purchase property for slow long-term capital gain and yield. But with house prices soaring recently they may have already achieved their wealth goal from existing investment property assets. They no longer need to invest again.

Sources of house price support

1. Rising construction costs

The more it costs to build a new house the greater the incentive for people to keep searching amongst listings of existing properties and the greater their willingness to raise their bid price.

2. Construction delays

Shortages of materials, labour, infrastructure, and council inspection timeliness mean projects will increasingly be delayed. Concerns about delays will curtail the speed with which the housing stock grows whilst also encouraging buyers to turn back to searching for existing property listings.

3. Sunset clause activation

Awareness of the risk that some developers will take advantage of delays to exercise clauses allowing them to cancel agreements with off-the-plan purchasers will also encourage some buyers to switch back to current property listings.

4. Construction firm closures

A lot of inexperienced, under-capitalised, under-financed people have and will soon enter the property development sector. Difficulties managing uncertain flows and prices of materials and staff will cause cashflow problems which banks will not always be willing to solve. Closures and failures will inject a level of caution regarding new builds by new operators which will not dominate the sector but will at the margin encourage some buyers to switch back to looking for properties through listings – or confine themselves to the large and long-established industry players.

5. 165,000 migrants

The government's recent decision to allow 165,000 migrants on temporary visas (including family members) to apply for residency visas, will open up the possibility of home ownership for some. This greater demand will be spread over a number of years, but it will nonetheless go some way to offset new government curbs on the number of migrants they will allow in.

6. Job security

The labour market is extremely tight and at some stage people will realise they have strong bargaining power and that there are many options beyond their current position. This will lead to New Zealand's version of the so-called Great Resignation underway in the United States – though one aspect of that for us will be people deciding that if they're going to shift for higher pay, they might as well make a big leap in income by hopping across the ditch.

Overall, once people realise they have high job security they are more likely to consider purchasing a home or investment property.

7. Backlog of buyers

The ending of the first nationwide lockdown last year revealed a surge in housing demand from the many young people who had been unable to find a property. While a lot of the backlog of frustrated buyers will have been cleared out recently by the stepping back of investors from March 23 providing space for first home buyers, there are probably plenty still remaining.

8. High household wealth

People's wealth levels on paper have soared in the past two years as housing and other assets have soared in price. Feelings of high wealth are likely to encourage some people to remain interested in gearing into another property.

But it pays to note there is a risk that the opposite effect listed above is larger.

9. High inflation expectations

People's inflation expectations have increased. If people expect inflation to stay high, they will seek to move their investments into assets which tend to at least hold their market value as the general level of prices goes up. This includes property, except to the extent it is funded with rapidly repricing debt which might become expensive.

10. High test interest rates used

Over the past few years banks have not tested the ability of borrowers to meet debt servicing requirements at the rate they have actually borrowed at, but at something perhaps 3% - 4% higher. A substantial interest rates buffer is therefore in place which will cushion the impact on the housing market as mortgage rates go up – but perhaps never actually reach the test rates which were used when people borrowed funds in recent years.

11. Christchurch catch-up

The long-overdue catch-up of prices in Christchurch began in winter and is likely to run through the next 2-3 years. Affordability in our second biggest city is much better than elsewhere and some internal migration to there from up north, by young buyers in particular, is likely to continue.

12. Bank panic will pass

For the moment, banks are restricting credit availability more than is likely to be the case to house buyers over the coming couple of years. They have stopped low deposit lending in some cases for fear of breaching the new rule that such lending cannot exceed 10% of all new lending. Willingness to lend at less than 20% deposit for existing properties will return. Banks have also been scrambling to meet new requirements of the CCCFA and over time they will form more realistic opinions as to which expenses to include and which income sources to allow. Hopefully, willingness to lend to those on variable incomes and entering their 50s will return also. Banks are also voluntarily experimenting with DTIs to get their systems up and running for when such rules are officially imposed. Experience will make DTI application eventually more efficient.

13. Development potential

Soon, virtually all sections of all sizes will be subdividable and developable in our top five cities. This possibility will make property owners more willing to hold onto their properties through tough times.

14. Forecast declines wrong

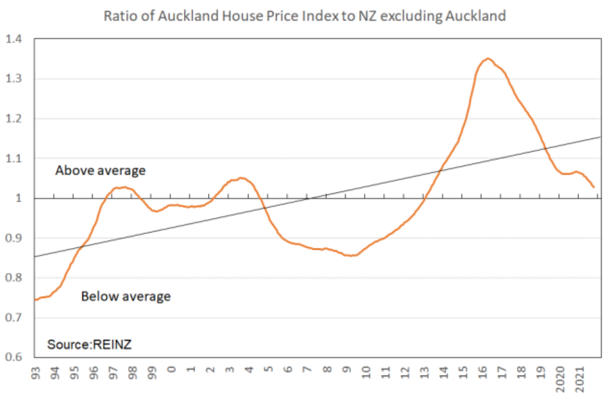
All forecasts of house price collapses have been wrong, and it is notable that last year as we learnt about Covid-19, border closures, and lockdowns, no mainstream prediction of house price declines came close to those made during the GFC. Almost all those who have believed decline predictions in the past and held off buying have been worse off. Experience will make people cautious about believing forecasts of big price declines and they will remain engaged with the market.

15. Auckland departees

Covid-19 and soaring paper wealth from higher asset prices have combined to encourage many older people to activate their downsizing and retirement relocation plans years earlier than they had been planning. This effect is likely to continue through 2022 and 2023 and be of benefit to the regions which seem to have benefitted most so far from Aucklanders relocating – Bay of Plenty, Waikato, Northland, Gisborne, and Hawke's Bay.

16. Auckland not over-priced

The last time the Auckland housing market faced "corrective" forces (ignoring the first lockdown) it was at a peak with prices well out of line with the rest of the country. That is not the case now and there is little reason for believing that our biggest city will experience a worse housing market in 2022-23 than anywhere else – in fact it may easily outperform a lot of the rest of NZ.



17. Higher listings will encourage buyers

Many people who would like to buy are not in the market currently because listings are hard to find. But listing numbers are already rising and will rise further as agents get less success selling to buyers without listing (friendly 'phone calls), vendors reluctant to sell for fear of not being able to buy lose that fear and list, and existing investors take profits and slowly react to tax changes.

18. Frenzy freedom

Many people wanting to buy a property have withdrawn from the market, tired of stress in auction rooms and the expense and time involved in repeatedly assessing potential properties in order to bid for them. As the market calms down, auction rooms become calmer (they already are), and a summer rest is hopefully achieved, these buyers will slowly re-engage.

19. No taxation double-down

One week after the March 23 tax changes I started delivering this warning. If house prices are still rising above 10% per annum come March 2022 a majority Labour government failing to achieve any improvement in housing affordability will conclude it did not go far enough with removal of interest expense deductibility for investors. They might double down and remove all other expense deductibility as well. The chances of that happening are now very slim given the slowdown underway.

In summary, the ending of the prices boom is good news for first home buyers because listings are set to improve and price growth will be slower. Its good news for good real estate agents as they will get more listings to transact. It's good news for investors because the risk of additional unfriendly legislation has fallen.

It's bad news for people who have paid excessive prices for development land in the past year, especially in the five cities for which new intensification rules will now apply. In those cities there is no longer a shortage of land.

Links to publications

Tony's View Spending Plans Survey

Spending Plans Survey

mortgages.co.nz & Tony Alexander Mortgage Advisors Survey

Tony's View Business Survey

Business Survey

Tony Alexander Regional Property Report

Tony's Thoughts Vlog

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